Costing, Comparing and Competing: Developing an Approach to the Benchmarking of Labour Market Regulation

DPRU Policy Brief Series

Development Policy Research Unit

School of Economics

University of Cape Town

Upper Campus

June 2008

PB 08-19

ISBN No: 978-1-920055-63-9

1. Introduction

Since the advent of democracy in South Africa, the regulation of the labour market has been a source of ongoing debate. There are, of course, political reasons for this. However, another reason is the fact that labour is often the only significant cost over which firms have some control. Labour legislation unquestionably circumscribes how that control is exercised, and imposes costs that firms would not have in the absence of such regulation.

A key question that arises is whether one can quantify the costs that labour regulation imposes, and compare such costs across countries. The World Bank's "Doing Business" (DB) Survey is by far the most ambitious such study to date. The idea behind DB is to benchmark regulation across different economies, and in so doing to stimulate labour market reform. Because the Bank is a global institution, this project has enjoyed a high profile.

This study is concerned with the validity of endeavours to measure labour regulation, and identifies a number of methodological problems that constrain any such endeavour. It then focuses specifically on the methodology employed in the DB survey, and its results for South Africa. It presents evidence that certain scores arrived at in the case of SA are incorrect, materially affecting South Africa's ranking in terms of the survey. These errors can be attributed to shortcomings in the survey's methodology as well as the simplistic conceptions of law reflected in the surveys. This finding does not imply that endeavours to measure the costs of regulation are without value.

2. Methodological Considerations in Costing Regulation

Against a background of increasing popularity of deregulation, a study was undertaken in 1999 under the auspices of the Department of Trade and Industry (DTI). Known as the National Small Business Regulatory Review, its goal was to assess the impact of all regulations affecting small business, including labour legislation. The value of the study was undermined by the failure to define small business satisfactorily.

A further study of employer perceptions in small, medium and micro enterprises (SMMEs) in Johannesburg was carried out in 2000, led by the World Bank. The survey sought to test the perceived effect on employment of each of the four labour statutes the new government introduced – the Basic Conditions of Employment Act (BCEA), the Skills Development Act (SDA), the Employment Equity Act (EEA) and the Labour Relations Act (LRA).

The statutes comprise a range of provisions, with very different effects. It is extremely difficult, if not impossible, to measure the impact of the statute as a whole, let alone four statutes, unless all that is being done is to measure perceptions. Measuring perceptions has validity insofar as perceptions shape conduct. But questions remain as to what these perceptions are of, and how they inform a response to the findings. There is no attempt to interrogate the accuracy of interviewees' understanding of the content of labour laws.

A more recent investigation of the impact of regulation by the Small Business Project adopts a similar approach to the World Bank study. Firms were asked to identify: "What factors most discourage you from hiring more employees?" Twenty percent of interviewees responded by saying "labour laws/government regulations in general", compared with 25 percent who answered "lack of confidence/demand in the economy."

The fact that "labour laws" are grouped together with a category "government regulations in general" makes the responses practically worthless.

Against this background, the appeal of the basis of the DB survey is obvious. It purports to be founded on quantitatively verifiable data, and can therefore be presented as objective.

In 2007, the DTI published an Investment Climate (IC) survey which relied heavily on the DB survey to supplement data based on employer perceptions. The IC is a survey of over 800 firms, conducted by a private agency in conjunction with the DTI and World Bank. On the question of labour regulation, it said that “when firms were asked whether certain areas of the investment climate were a problem for business, close to 33 percent said that it (labour regulation) was a major or very severe obstacle…” The survey concluded that the “burden of labour regulation” led to “quite a sobering” assessment of South Africa’s competitiveness. However, this paper argues that the DB data do not provide a basis for making this type of assessment – whether positive or negative.

3. The World Bank’s Doing Business (DB) Survey

The assumptions of the survey on the “standardized employee” are very specific (and based on a study done by Botero et al.) The employees are male and have been working for the same firm for 20 years. The firm is engaged in manufacturing, employs more than 200 workers, is wholly owned by nationals, etc.

These assumptions for South Africa focus on fairly large firms, and certainly not the kind of business that has been the focus of the debate about labour market regulation. This is the kind of firm that a foreign investor might be interested in establishing.

It is enlightening to consider some of the comments about regulation that appear in the DB report:

- Cumbersome regulation is associated with lower productivity.
- Heavier regulation is associated with informality and corruption.
- Poor countries regulate business the most.
- Heavier regulation brings bad outcomes.
- One size can fit all, in the manner of business regulation.

The sweeping nature of these propositions is striking, and gives rise to the question: “What precisely is meant by regulation?” No attempt is made to define what is meant by regulation. This underscores the fallacy that “poor countries regulate most”. The report acknowledges elsewhere that these same countries have the least capacity to enforce regulation. It is misleading to analyse regulation in isolation from enforcement.

DB assumes that the cost imposed on an employer has negative economic consequences for that employer and the economy as a whole. DB takes no account of the capacity of labour market regulation to produce greater equity.

The DB index ignores the fact that many of the real impacts of a law may stem from the way it is interpreted or applied by functionaries such as arbitrators, judges, labour inspectors, stakeholders such as employers, employees and trade unions, as well as professionals such as labour consultants and lawyers. The World Bank has accepted that some of the costs of unfair dismissal law in South Africa arise from “misinterpretations” of the law.

4. The "Doing Business" Methodology Applied to Labour Legislation in South Africa

Three indices have been constructed to measure employment regulation, namely the "difficulty of hiring" index; the "restrictions on expanding or contracting the number of working hours' index", and the "difficulty of firing" index, which, curiously, is exclusively concerned with the situation of redundancy. The average of the three indices provides a "rigidity of employment" index.

Sub-Saharan Africa does not fare well on this index. The continent scores 47,1, compared with a rating of 23 for East Asia and the Pacific. South Africa scores 41 and Mozambique 54.

4.1 The "Difficulty of Hiring" Index

This measure is concerned with hiring by means of part-time or fixed-term contracts. Part-time work, it argues, is attractive to businesses where countries exempt part-time workers from the benefits that apply to full-time workers, and because part-time contracts are easier to terminate.

The focus of the inquiry is on fixed-term contracts, which merits the first question:

i) *Whether term contracts can be used only for temporary tasks.*

South Africa is rated negatively on this question, as a country that permits fixed-term contracts only for temporary tasks. This is not correct. There is no prohibition in the law on the use of a fixed-term contract for any type of task and any type of employment. Widespread use is made of fixed-term contracts by temporary employment services, contract cleaning firms and security services, among other sectors, even where the employees concerned are in effect employed indefinitely.

Contrary to the DB rating, South Africa employers have a considerable level of flexibility to employ workers under fixed-term contracts.

ii) The maximum cumulative duration of term contracts.

Here South Africa scores positively, which is further proof that the rating given to South Africa on the previous question is incorrect. If term contracts can only be used for temporary tasks, then the maximum cumulative duration of term contracts must logically be the period for which the temporary task endures.

iii) The ratio of the mandated minimum wage for a trainee or first-time employee to the average value added per worker

The rationale for including this question as part of the difficulty of hiring index is that the lower the ratio between the wage that an employer is required to pay a new employee and the average value added per worker, the more likely an employer is to employ new employees. The average value added per worker serves as an indicator of productivity.

South Africa's ratio was calculated as being 0,46 in 2006 and 0,67 in 2007. The basis of this calculation is not apparent from either the reports or the website and there is no published or accessible information indicating what assumptions were made or why there is such a large increase between the two years. These difficulties indicate why the rating provides no guidance about the real difficulty associated with hiring employees.

The question here is whether there is something in South Africa that could be described as a "mandated minimum wage for a trainee or first-time employee"? Bargaining council agreements do set minimum wages, but most employees are not covered by bargaining council agreements. It is also highly inappropriate that a scheme to incentivise employment of learners should be classified as a "mandated minimum wage."

If the assumptions on which the DB survey purports to be based are in fact of limited application, then limited weight can be attached to the answer. This is the case for South Africa and may well be true of other countries that regulate minimum wages, but do not do so comprehensively.

4.2 The "Rigidity of Hours" Index

One of the aspects looked at here is whether night work is restricted. Here, the question was sometimes phrased as whether night work is "allowed" and whether is it is "unrestricted". South Africa allows night work, but because the DB survey researchers felt it was restricted here, the country scored a negative rating on the question.

However, the Basic Conditions of Employment Act of 1997 (BCEA) does not impose any specific limitations on the number of hours that can be worked at night, nor does it require the payment of a "specific premium". It does, however, require that some compensation be paid.

This is a far cry from completely banning night work; yet South Africa receives the same rating as a country that prohibits all work at night, or work by women at night, or in which legislation imposes a mandatory pay premium for night work in all sectors of the economy.

4.3 The "Difficulty of Firing" Index

Here the focus is exclusively on the costs of redundancy, which would affect foreign investors more. But evidence suggests that, for South African employers, the costs associated with terminating employment are determined to a greater extent by cases of misconduct rather than redundancy.

On the issue of whether the employer needs to notify a third party (such as a government agency) to terminate one redundant worker South Africa scores a negative rating. This rating is incorrect.

It is true that, in South Africa, consultation is required with a trade union or workplace forum. But this is not the same as a government agency. The DB survey assumes equivalence between the need to consult a trade union with the need to consult a government department.

In practice in South Africa, there is no need to consult the union if the employee to be made redundant is not a trade union member. A possible explanation for the rating South Africa got is that respondents did not take into account the fact that the employee concerned was a non-union member. This again illustrates the extent to which the particular assumptions affect the rating one way or the other.

The same arguments hold on the question whether an employer needs to notify a third party to terminate a group of more than 20 redundant workers.

On the issue of whether the law requires the employer to consider reassignment or retraining options before redundancy termination, South Africa scores a negative rating. But the question is whether this is an actual "rigidity" as the onus on the employer is merely to consider.

On the issue of whether priority rules apply for redundancies, South Africa receives a negative rating, but this was changed to positive in 2007. The DB gives no indication of what is regarded as a "priority rule". In South Africa, legislation requires that employees are retrenched in a way which is fair and objective. The *Code of Good Practice: Dismissal* sets out criteria which are generally accepted to be fair, which include the principle of seniority articulated through the "last-in first-out" principle. However, the Code is permissive, and emphasises that each case is unique.

The conclusion that South Africa has priority rules appears to be based on the case law interpreting the legislation, which is not permissible in terms of the DB methodology.

Conclusion

A large section of the paper deals with developing indicators for South African labour market regulation, including aspects such as the casualisation of the labour force and the fact that many employees are not covered by legislation; the number of days allowed to work; unfair dismissal and the role of the Commission for Conciliation, Mediation and Arbitration and collective bargaining. In this policy brief, the emphasis has fallen on the World Bank's *Doing Business Survey*, which purports to be an objective measurement of the costs of labour market regulation in countries, including South Africa. The paper finds that the DB survey has many methodological shortcomings, and has made some mistakes in its assessment of South Africa.